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For an Innovative European Fiscal Model**

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Family Emergency: For an Innovative European Fiscal Model

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Abstract

Family is the central structure of our society: the huge importance of family in the society is a definitive result of decades of sociological studies. Otherwise, the economic difficulties have persuaded European countries to cut policy tools to support families and as other studies reveal, austerity packages affected family policy to various degrees.

This is the reason of the importance to change the system to invest on family. A different use of fiscal policy would be a good strategy. But this solution needs to solve other problems.

First is the choice of the best fiscal unit for an equal system. The classical fiscal system shows two main models: an individual model (also called separate taxation model) and a family model (also called joint assessment model); actually we can find hybrid solutions, too. But on the other hand, their failures show the need to go beyond.

If the study tries to demonstrate that family (thought as a central unit characterised by a generation continuity) is probably the most appropriate unit to identify the potentiality of well – being and therefore the taxable capacity of each one, the changes in family structure show the necessity to use a new concept of family (more flexible and realistic) in the law system and in the fiscal system, too. A new and more equal fiscal system (with a balanced mechanism of deduction and not only) would be able to absorb and substitute the various tools and allowances for family and to transform itself in payments for poor families.

Secondly, economic globalization and migratory flows show the necessity to a supranational fiscal model which each country can inspire to.

Even if Europe has not real power in direct taxation, one European model of family taxation could be useful to guarantee against discrimination and ensure the effective right to move freely, live and work everywhere in the Union.

Keywords: Family, Tax Benefits, Cross – border families, Supranational Family Fiscal Model.

Introduction

Family is a fundamental structure of our society. It is the central unit in many different systems (juridical or not) and has always played a very important role on different levels.

It has always been at the centre of juridical, economic and normative studies and the family policies have crucial effects at various levels.

“Families are the cornerstone of society. They play a central economic role, creating economies of scale for people living together and as the source of home production. They are a crucial engine of solidarity, redistributing resources (cash, in-kind or time) among individuals, households and generations. They provide protection and insurance against hardship. Families offer identity, love, care and development to their members and form the core of many social networks”. This is the opening sentence of the foreword of an OECD publication titled: *“Doing Better for families”*. In accordance with the results of decades of studies and as it is common knowledge, investment in families has positive effects on the whole society: it can contribute to a rise in female and maternal employment, tackle poverty among such households and has good influence on the child’s education and on the whole economic system. On the other hand, the different features that the family has had to be assumed as a result of the significant demographic, economic and social changes, as well as the new roles that it has to play, which have long ago opened a wide debate on the best policies for a familiar scenario which, in general, is characterised by a decrease in birth-rate, a rise in the average life expectancy and, consequently, a greater number of older people.

Notwithstanding, the global economic crisis has persuaded European countries to cut policy tools used to support families. As the OECD studies reveal, austerity packages affected family policy to various degrees. Ireland has lowered the age of children eligible for family allowances; Germany has reduced the monthly allowance to take care of children until the 14th month; the UK has reduced the number of families eligible for child tax credit and Spain has abolished the birth grant for each new born. Furthermore, we must not forget that cuts in other areas also affect families, for example, reductions of Social Assistance and Housing Benefit, freezing or reducing public salaries, etc. Table 1 examines the Union in its different geopolitical areas.

Table 1. *The Five Geographical Areas that Characterised Family Policies in the EU*

<i>French speaking</i> (France, Belgium, Luxembourg): development of family policy much generous and organised
<i>German speaking</i> (Germany, Austria): family policies based on family-institution developed, but less significant in the social sphere: generous public financial intervention, less in public services
<i>Scandinavian</i> : not direct interventions for the “family”, but very important development of the welfare system based on equality of the sexes, child policy, conciliation between family and work
<i>English speaking</i> : non – intervention policies. Prevalent interventions towards poverty and social marginalisation (community care)
<i>Mediterranean</i> : no development of coherent policies, fragmentary interventions; very limited system of money transfers

Fiscal Point of View

From a tax perspective, the family is a typical taxpaying unit in the income taxation systems. A taxable subject can be defined as a taxpaying unit (individuals, married couples, families, business entities, and so on) that realizes that taxable income, is liable to pay taxes and is obliged to account for the income tax to tax authorities. As it is clear from the economic literature, the progressive income tax makes the choice to tax individual or family income not indifferent¹. If the family taxation is justified in considering that the ability to pay tax of the individual depends not only on its individual income, but it is unquestionably influenced "by the resources of the nucleus where it belongs," the option to the individual taxation is essentially based on the need to recognize to each one the "sovereignty" to choose how to use his resources. In this latter case, the tax is applied on the income of each member of the household and, at best, with mechanisms of deduction for dependent members. It should be noted that the EU countries differ in the choice between “individual” and “familiar” taxation, and both has positive and negative features. The adoption of the tax unit (individual/family), in fact, depends on the fiscal policy that each country desires to pursue at a given moment and, therefore, the goals that it seeks to achieve.

The Tax Unit: Classical Models of Income Taxation System

The income taxation systems show two main models: an individual model (the so-called separate taxation model) and a family model (the so-called joint assessment model); actually, we can find hybrid solutions, too. France, Luxembourg, Portugal and Switzerland adopt a family model; Belgium, Germany, Ireland, Norway, Poland and Spain give the chance to opt for one or

¹ See Declich, Polin, Individuo e famiglia: quale fisco?, in Riv. Dir. Fin. Sc. Fin., 2007, 2, I, p. 149, and Yonah, Sartori, Marian, Global perspectives on Income taxation Law, Oxford, 2011, p. 67.

for another system; so, the great part of European countries have an individual system.

Actually, since the 1970s the family model was the most common one, but between 1970 and 1990 many countries opted for the individual system. It happened in Italy, in the UK, in Sweden, in the Netherlands, in Finland, in Austria, but it is difficult to find one common reason. In Scandinavian countries the impression is that it depended on the will to improve female work²; in Italy the chosen family system (the so-called “cumulo giuridico”) did not harmonize itself with the constitutional principles and it was declared illegal by the Constitutional Court³; in general, we can say that the need was a better redistribution of income together with the will to decrease the disincentive for the spouse’s entering in the labour market or to concentrate allowances to the lowest income families.

Moreover, economic studies results show that the average tax rates for secondary earners are much too high not only in the case of countries adopting joint taxation, but also for those countries adopting individual taxation, so the classical objection to family tax system does not work, yet.

The model of individual taxation focuses on the individual and his/her direct income. Usually some corrective actions are applied (in the form of tax credits and/or deductions when there are dependents) in the case the individual would have family “burdens”. The use of a system of individual taxation does not prohibit you, however, from considering the potential of the family and its undeniable importance in the different assessment purposes. As the Italian experience demonstrates, the new *redditometro* (a biting tool to fight tax evasion) allows the reconstruction of the synthetic income of the family and the selection of shady positions to be submitted to further testing. The tool, in practice, allows to verify whether the total income of the family corresponding to the family standard of living. In negative case, Fiscal Administration will be able to synthetically investigate the single individual positions.

The model of family taxation, on the contrary, considers the family as a tax unit and, each individual is treated as part of the family. The most common methods used to tax family income are: income – splitting system or family quotient system. Under income - splitting systems, the income - usually that of the spouses - is first added and then subdivided into equal parts and the rate applied is that which corresponds to this amount. In this case, the total tax will be double the rate calculated on the single quote. Children are treated as separated taxpayers for most tax purposes. Under family quotient systems, taxable income is divided by further amounts to take account of the existence of certain dependants, most importantly minor children, whether or not these dependants have their own independent income. A family share. In these tax

² H.J. Kleven & C.T. Kreiner, The taxation of married couples in OECD Countries: a need for reform?, No 02-13, EPRU Working Paper Series from Economic Policy Research Unit (EPRU), University of Copenhagen, .

³ Sent. n. 179/1976.

systems we usually can find different forms of tax relief; the two forms most used are known as “tax allowances” and “tax credits”⁴.

As thorough economic studies demonstrate⁵, the different tax systems may have important repercussions on the economic and social choices of the individuals which one cannot disregard (Table 2).

Table 2. Comparison of Different Tax Systems

	Individual taxation	Joint taxation	Family share (splitting/quotient)
Marital status	Neutral	Not favouring marriage	Favouring marriage
Tax avoidance	Favouring the imputation of the wealth to the spouse with the lowest income	Neutral	Neutral
Vertical equity	Depends on the rate's structure	Depends on the rate's structure	Splitting and quotient gives an advantage that arises with the increase of the income
Number of family member	It can use deductions and detractions to consider family expenses	It can use deductions and detractions to consider family expenses	Quotient considers the need's structure by the increase of the family
Job offer	Not favouring a single-income family; thus it favours the job offer of the second spouse	Not favouring the job offer of the second spouse	Not favouring the job offer of the second spouse

A Case: Italian Situation and the Debate within It

In Italy, as you know, the family is the most important cultural value and you rely on family networks to do business. In spite of this, the family policies which have been adopted have hardly given some space to services, excluding education and health, and have virtually ignored the issue of a home, especially with regard to young families⁶. The *favor familiae*, which in the Italian system

⁴ For a brief explanation see Messere, K, Taxing and aiding EU families, European Taxation: official Journal of the Confédération Fiscale Européenne, Amsterdam: Bureau, 2003, 12, p. 445.

⁵ C. Rapallini, *Il quoziente familiare: valutazione di un'ipotesi di riforma dell'imposta sul reddito delle persone fisiche*, 2006. See also KREINER, C.T., & KLEVEN, H. J., The Taxation of Married Couples in OECD Countries: A Need for Reform?, No 02-13, EPRU Working Paper Series from Economic Policy Research Unit (EPRU), University of Copenhagen, p. 4 et seq., and Messere, K., supra.

⁶ Only with the so called “Legge di Stabilità 2016” [2016 Finance Law] (L. n. 208 28.12.2015) innovative benefits for young married couple have been introduced.

is guaranteed by Art. 31 of the Constitution, according to which “the Republic aids the formation of the family and the fulfilment of its duties, with special focus on large families, through economic measures and other provisions”, has largely concentrated on the sphere of *welfare* tax. From a tax perspective, Italy, after a short period is characterised by a joint taxation system and has a system of individual taxation that includes a series of correctives (tax allowances and tax credits). The inadequacy of the system is confirmed by the lively debate that we are witnessing and by the many initiatives the Italian legislative system offers. A very interesting one emerges from “a white book” presented in February 2008 by the commission appointed by the Deputy Minister of Finance at that time (Vincenzo Visco): it proposes the introduction of a new form of universal transfer: the so called **ARF** (Allowance for Family Responsibility), with which the national family allowances would be extended to all the families and tax credits for family dependents would be converted into tax credits payable in the eventuality you do not reach the tax capacity. Another one, which is recommended by various associations, as well as by the Observatory for the family, is called **Family Factor**: it is an innovative method and a clear expression of the so-called “Tax subsidiary.” At its core, there is the principle to establish and quantify the necessary costs of the maintenance and the growth for each member of the household. The sum of these costs and the contributions of all family dependents determine a sort of no tax area, in which the rate is zero. Beyond the no tax area there are the usual progressive rates.

The European View

The globalization of the contemporary society among its many effects offers, with increasing frequency, situations where the family goes beyond the borders of a single state, both because the components of the same have different nationalities and because the activities of the same family members involve in different states.

This often leads to conflicts between rules of jurisdictions that distinct national laws are not always able to solve, but which, above all, too often end up damaging the members of those families, exposing those transnational relationships to discriminator treatments.

We have to remember that modern systems of income taxation do not give any importance to citizenship. On the other hand the space value of tax rules justifies different taxations inside or outside the national borders of each state. In particular, the taxation of residents, in the modern tax systems, is informed to the so called *world wide income taxation* criterion (also called global income taxation), while non-residents are taxed only on income earned within the state. Well, in the calculation of the income tax, for the latter (non-residents), the personal deductions and the family tax credits are not allowed. Accordingly, international tax laws recognize that the overall taxation of taxpayers, taking account of their personal and family circumstances, is a matter for the State of residence.

However the strict application of these rules, linked with particular circumstances, may cause violation of the free movement of persons (with the corresponding prohibition of discrimination) which is the basis of European legislation.

In spite that the European law does not place clearly among its objectives the protection of the family⁷ and the direct tax harmonization is still a pure aim⁸, more and more often we can see interventions by the Court of Justice seeking to remove the frequent tax law discriminations occurred when the taxpayer and his family do not exhaust their importance in a circumscribed territory as that relating to a single Member State⁹.

In its case law the Court of Justice on several occasions had to decide about the use, by cross – border families, of more favourable taxation mechanisms, such as splitting - system, and it was thanks to its enlightened jurisprudence which they have been generally applied (as, for example, the German splitting system). Thanks to the well known Schumacker case, in 1995 a legislative amendment which allowed not only to spouses living in Germany but also to those households whose members, despite not having the domicile or habitual residence in Germany, are citizens of one of the EU states, to be able to enjoy the splitting system, was introduced into German law.

The Court, while acknowledging this: "... Although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community", has affirmed that: "the powers retained by the Member States must nevertheless be exercised consistently with Community law". In particular, using the Treaty right to free the movement of persons, the Court points out that "With regard, more particularly to the free movement of persons within the Community, Article 48(2) of the Treaty requires the abolition of any discrimination based on nationality between workers of the Member States as regards, *inter alia*, remuneration".

⁷ As observed in Queirolo, I., & Schiano Di Pepe, L., *Diritto di famiglia e Unione Europea*, [Family Law and European Union], Turin: Giappichelli, 2008, p. 169, the European Union has not, up to today, have a specific competence in the approval of binding acts about family law; but there is something else: in the previous treaty we can not find any reference to family (exception for Article 65 Ce Treaty): no traces of the term in the articles conferring upon the European institutions exclusive or concurrent competences.

⁸ See Melis, G., *Coordinamento Fiscale dell'Unione Europea* [European Union Tax Harmonization], in *Enc. Dir. Annali*, I, Milan, 2007, p. Milan, 2007, p. 397; the same Court of Justice, from the sentence C-246/89, underline that "Although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law". This law case is expression of the so called "Hubbard rule" (C-20/92), by which the strength of European Law is the same in different national law sectors. See also, Van Thiel, S., *Free movement of persons and the income tax law: the European Court in search of principles*, Amsterdam, 2002, p. 155.

⁹Tizzano, *Il ruolo della Corte nella prospettiva dell'Unione Europea*, in *Scritti in onore di Predieri*, [The EUCJ role in the EU perspective, in Writings in honor of Predieri] Milan, 1996, III, p. 1459, observes that no other European Institutions, like the Court of Justice, has done a so important and effective action to improve the integration process. See, also, Van Thiel, *cit. note above*.

The consequence is that the workers of a Member State should enjoy in the territory of another Member State the same tax breaks of national workers; it can not tolerate that one Member State treats a national of another Member State - that making use of his right to free movement carries on its work in the host Member State, while remaining a resident with his family somewhere else - less favourable than a national who is in the same situation. The principle is a constant in the jurisdiction of the Court: we find confirmation in the Asscher¹⁰ and Gschwind¹¹ assessment where it can be read that "...that although direct taxation falls within the competence of the Member States, the latter must none the less exercise that competence consistently with Community law and therefore avoid any overt or covert discrimination by reason of nationality". And recently, in the Ettwein¹² case and in Beker & Beker¹³ case, the Court told the same¹⁴.

The Criticalities

Family has always been at the centre of important normative, economic and sociological studies, and all of them seem to be moving towards the same direction: the family is the foundational structure of our society and the support policies of the family have crucial effects at various levels. On the other hand, the serious economic difficulties compel us to rethink the way to spend on family. A good idea would be using taxation in an altogether innovative manner, in order to ensure a fairer and more balanced treatment of the family; in such a way that it can be able to ensure the required resources to carry out that proactive and stimulating function that it has within the society. The fiscal instrument, if properly balanced, may be able to absorb and replace most of the subsidies that are paid to families in a variety of ways (family allowances, bonuses, various benefits, etc.), thus avoiding the perverse mechanism that with one hand takes and with the other gives, which often, due to the lack of coordination between the two steps, causes the impoverishment of the families that are compelled to resort to the public aid exactly because of the inconsiderate levy they are obliged to pay. On the other hand, the presence of poor families or those close to poverty levels calls for the use of support tools

¹⁰ Sentence 27th June 1996, C-107/94.

¹¹ Sentence 14th September 1999, C-391/97.

¹² Sentence 28Th February 2013, C-425/11.

¹³ Sentence 28th February 2013, C-168/11.

¹⁴ We have to add that the Court has gone above and beyond with Imfeld & Garcet ruling (EUCJ 12 Dec. 2013, C-303/12) a particular law case that even if can be included in the so called Schumacker – doctrine, contains some innovative principles. In this sense, see NIESTED, H., Growing Impetus fo harmonization of personal and family allowances: current state of affairs of the Schumacker – doctrine after Imfeld and Garcet, EC Tax Review 2015/4, p. 185; Peeters, B., Mobility of EU citizens and family taxation: a hard to reconcile combination, EC Tax Review, 2014/3, p. 118, and Cerioni, L. , Guido Imfeld and Nathalie Garcet v Belgian State: a continuation of the Schumacker doctrine?, British Tax Review, 2/2014, p. 128.

which, such as the negative income tax, allow the transformation of tax credits into real cash payments. The tax law usually refers to a concept of family governed by civil law, but according to the social changes the traditional family concept (one man and one woman with one or more children) is an obsolete view: families are changing and many European countries offer legal protection to other types of cohabitation and to same – sex relationships¹⁵. The family changes are there for all to see: life expectancy is higher, birth rates lower; in many families there are more grandparents and fewer children. People marry at older ages, marriages end in divorce more often and remarriages are increasing. Scholars speak about “family constellations”¹⁶ that are blended families of re-partnered adults or families with sole parents, one or more babies and other households (like siblings, uncles, aunts, mother, etc.). A sort of extended family, but with very close economic relationship that is no longer possible to ignore¹⁷. All this is further complicated by the massive influx of new individuals who bring with them cultural traditions and different religious beliefs, hence making us aware of an altogether different family model: the social and multi-religious evolution of the family is an unstoppable fact which one cannot not take into account in the preparation of new policies concerning the family. The new concept of family has to be extended to more complex forms of cohabitation, in as much the same way as has the role of women assumed the double function of partner and worker equal to her spouse. We must overcome the restrictive view of the family as a place wherein you manage your personal and private relationships, the functions of the continuity of the species, the protection of the disabled, etc., and is also seen as a place

¹⁵ As it is clearly illustrated by Ordower, H., Comparative Law observations on taxation of same – sex couples, in Tax notes, April, 10, 2006.

¹⁶ In this sense, see: Mastelloni, S., Nuove costellazioni familiari – Le famiglie ricomposte, [New familiar constellations – Blended families] Milano 2002. For a thorough analysis, see Pocar, V., & Ronfani, P., Coniugi senza matrimonio – La convivenza nella società contemporanea [Spouses without marriage – Cohabitation in present – day society], Milano, 1992; Fuccillo, A., Unioni di fatto, convivenze e fattore religioso [Registered partnership, cohabitations and religion], Turin, 2007; Pezzini, B., Tra famiglie, matrimoni e unioni di fatto – Un itinerario di ricerca plurale, [Among families, marriages and registered partnerships – A plural research itinerary] Naples, 2008. It has been critically observed, Martone, M., Le famiglie si allungano ma la crescita si accorcia [Families extend, but the growth reduces], in il Sole24Ore 23rd May 2011, p. 7 that “families keep getting bigger while growth decreases”. Once, families were “horizontal”, in the sense that everyone had many brothers, cousins, probably a few grandparents and hardly any great-grandparents. Nowadays, however, the development is vertical: a few brothers and cousins, quite a number of grandparents and possibly a couple of great-grandparents. If, of course, medical progress and the improvement of lifestyles that have extended life expectancy are among the main causes (positive) of this change, other disturbing signs of some trends (anything but positive) are at the basis of such changes and could have important repercussions on our lifestyles: surely the fall in the birth-rate that somehow characterises, even if in different ways, all the developed countries and also a kind of generational selfishness: “in other words, that trend which now even calcifies the laws of every generation to only live short term, consuming as much wealth as possible without taking care of those who are yet to come”.

¹⁷ M. Leroy, Sociologie de la fiscalité de la famille, in La tassazione della famiglia: aspetti nazionali e comparati, [Sociology of family taxation, in Family taxation: national and comparative aspects], Turin, 2000, p. 143 - 168.

where strong economic and financial relationships are concentrated. The new concept of family requires to rethink the taxation model and to verify what has been achieved so far. Sociological and legal studies about new family structures will give us a good base on which we can build a new concept of family which can be useful in the fiscal system, obviously.

Findings

The social changes need to reconsider the role of the family in the fiscal system and to verify its importance and utility. The importance of a new concept of family in the fiscal system is clear in those authors¹⁸ who asserts family should remain the central structure of the society and the best fiscal unit for an equal system: family, in their opinion, is the most appropriate unit to identify the potentiality of well being and therefore the taxable capacity of each one.

It follows that family should be certainly fiscally protected with facilitated ad hoc statutes in order to safeguard its survival and stability, especially in this time of economic precariousness, but the nature of an economic entity, almost in an equal position with businesses, must be understood (and probably enhanced) in a huge sense that puts it in the middle, between the previous and the future generations, as suggested by the most innovative economic studies¹⁹. However, according to the changes in the family structure, we have to think about family not only in a different way, but, probably, we have to rethink of a new fiscal family concept as an innovative unit for a more equal system: turning upside down the typical way of doing, we have to create a new fiscal family concept and not to use a family model from other sectors; the best way is probably to perceive it as a central unit characterized by generational continuity; evaluating the generation continuity implies valuing the interactions among all the family members²⁰. The daughter or the son who pays the cost of the therapy for their mother or their father have to deduct these expenses, likewise old relatives who sustain their sons and daughters who have physical or economic difficulties have to deduct these expenses. On the other hand, estate taxes, inheritance taxes and consumption taxes should not penalize the investment in dwelling house or the fundamental expenses, and not absorb income benefits.

To complicate matters, the studies, which until now have dealt with family policy and taxation, have remained in national borders and at most have used a comparative method. They have established that family policy is one of the social policy areas with greater disparities among European countries. They

¹⁸C. Sacchetto, *La tassazione della famiglia: il modello Italiano*, in *La tassazione della famiglia: aspetti nazionali e comparati*, [Family taxation: the Italian system, in Family taxation: national and comparative aspects], Turin, 2010, p. 63 - 94.

¹⁹ See Alesina, A., & Ichino, A., *L'Italia fatta in casa. Indagine sulla vera ricchezza degli Italiani* [Italy homemade. Study on true Italian wealth], Milan, 2009.

²⁰ In this sense Sacchetto, C., *supra*, p. 91.

agree with the importance of a better coordination and harmonization between family law and social policies, but they have to admit that a convergence in EU countries will only be possible in the future if a greater cultural affinity in family values and a closer similarity in production systems are there. In this context, the EUCJ activity shows a constant trend from which emerges “the importance of ensuring the protection of the family life of the Member States in order to eliminate obstacles to the exercise of the fundamental freedoms guaranteed by the Treaty”²¹. The protection of the family is not only a mean in the defence of fundamental freedom, but it has its own fundamental importance and it is a very noteworthy “tile” in the complex puzzle of European harmonization. We can find evidence of this in the Communication adopted in December 2010²² by the European Commission on removing cross – border tax obstacles for EU citizens and, the next year, in another communication, “Tackling cross – border inheritance tax obstacles within the EU”²³, and in other important documents, too²⁴.

We have to remember that in April 2014 the Commission services launched two public consultations: the first, for information on tax problems faced by EU citizens when active across borders within the EU, and the second, for information on cross – border inheritance tax problems within the EU. In April 2014 a directive on measures facilitating the exercise of rights conferred on workers in the contest of freedom of movement for workers has been adopted, too. It focuses on guaranteeing a more effective and uniform access to social and tax advantages to the EU workers and the members of their family exercising their right to free movement. The fundamental European freedom, as shown, is the most effective mean usable to reach an authentic integration, not only cultural, and a genuine equal treatment in the tax field, too. Taxation is no longer a private Member State’s business and tax integration has in family, one of the most important role. Postponing the decision to intervene on family affairs is a dead end.

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²¹ EUCJ, 11 July 2002, Case C-60/00, *Carpenter v. Secretary of State for the Home Department*.

²² Com (2010) 769, 20 Dec. 2010.

²³ Com (2011) 864, 15 Dec. 2011.

²⁴ I.e. a Recommendation regarding relief for double taxation of inheritances (2011) 856/EU, and a Working Paper, *Non discriminatory inheritance tax systems: principles drawn from EU case – law*, SEC (2011) 1488.

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